BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA

DOCKET NO. 2018-319-E

In the Matter of:	)	
	)	**REBUTTAL TESTIMONY OF**
Application of Duke Energy Carolinas, LLC	)	**JOHN L. SULLIVAN, III**
for Adjustments in Electric Rate Schedules	)	**FOR DUKE ENERGY**
and Tariffs and Request for Accounting Order	)	**CAROLINAS, LLC**

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND CURRENT POSITION.

A. My name is John L. Sullivan, III. My business address is 550 South Tryon Street, Charlotte, North Carolina. I am employed by Duke Energy Business Services, LLC as Director, Corporate Finance and Assistant Treasurer. I am also the Assistant Treasurer of Duke Energy Carolinas, LLC ("DE Carolinas" or the "Company").

Q. DID YOU PREVIOUSLY FILE DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes, I did.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to portions of the testimony filed by Mr. David Parcell, witness on behalf of the South Carolina Office of Regulatory Staff ("ORS"). In my testimony, I will address Mr. Parcell's recommendation for the embedded cost rate of long-term debt. I will also address Mr. Parcell's recommended Return on Equity ("ROE") and the financial impacts to the Company from the overall revenue requirement recommendation of the ORS.

Q. PLEASE PROVIDE AN OVERVIEW OF YOUR TESTIMONY.

A. In my direct testimony, I advocated using DE Carolinas' cost of long-term debt of 4.63%, which was the actual rate calculated as of December 31, 2017. Mr. Parcell's direct testimony recommends updating the cost of long-term debt to 4.44% based solely on 2018 debt issuances utilized in part to refinance three long-term debt maturities. In my rebuttal testimony, I explain that the Company does not oppose updating the cost of long-term debt, but recommends a rate of 4.53%, reflecting the actual cost of debt as of December 31, 2018.

Next, I examine the detrimental impacts to the Company of Mr. Parcell's recommended 9.30% ROE and the overall revenue requirement proposed by the ORS. The ORS's recommendation does not take into account the adverse impacts the reduced cash flows would have on credit quality. These impacts could be severe, to the detriment of the Company's credit quality and the interests of its customers. DE Carolinas maintains its own credit ratings, issues its own debt securities and maintains its own equity. The Company's regulatory capital structure and allowed ROE are key components in maintaining the Company's current "A" credit ratings and its overall financial strength and flexibility.

Q. ORS WITNESS PARCELL PROPOSES TO CHANGE THE COST OF DEBT FROM 4.63% TO 4.44%. DO YOU AGREE WITH THIS ADJUSTMENT?

A. The Company does not oppose updating the cost of debt to reflect the Company's cost of debt as of December 31, 2018. However, the Company does not agree with Mr. Parcell's recommended rate of 4.44% as this only reflects a partial update. Instead, the Company recommends the cost of debt be updated to 4.53% to reflect changes in debt through December 2018 as further described below. Please see Sullivan Rebuttal Exhibit 1, which includes my cost of debt calculation.

While Mr. Parcell's updated cost of debt reflects 2018 long-term debt issuances, his calculation ignores other changes to the Company's debt profile also occurring in 2018. In addition to the long-term debt issuances, the cost of debt should be updated to reflect changes in interest rates on floating rate debt, as well as updates to reflect year-end balances of amortizing debt, debt discounts and fair value hedges on cancelled swaps. Also, the Company entered into an approximately $52 million, 20-year capital lease in 2018, which was omitted from Mr. Parcell's cost of debt. Updating the cost of debt to reflect these changes to the Company's debt profile, in addition to Mr. Parcell's update for 2018 long-term debt issuances, results in a cost of debt of 4.53%, as shown in in Sullivan Rebuttal Exhibit 1.

Q. WITNESS PARCELL'S ANALYSES ESTIMATED THE COMPANY'S ROE TO BE IN A RANGE OF 9.10% TO 9.50%, WITH A RECOMMENDED MID-POINT ESTIMATE OF 9.30%. HOW DOES THIS COMPARE WITH COMPANY WITNESS ROBERT HEVERT'S ROE RECOMMENDATION?

A. Mr. Parcell's 9.30% ROE recommendation is 145 basis points below Company witness Hevert's recommended point estimate of 10.75%. In his direct testimony, and maintained in his rebuttal testimony, Mr. Hevert believes that an ROE in the range of 10.25% to 11.00%, with a point estimate of 10.75% is commensurate with his quantitative and qualitative analyses of DE Carolinas. As stated in my direct testimony, the Company fully supports Witness Hevert's proposed ROE and analysis, yet offered a 25 basis point concession with rates being set in conjunction with a ROE of 10.50%. Approval of this request will allow the Company to maintain its healthy credit profile, generate adequate cash flow to support its critical capital investments, and fairly balance the needs of affordable electric rates for customers and an acceptable ROE for equity investors.

Q. WHEN DECIDING WHERE TO INVEST CAPITAL, DO INVESTORS CONSIDER EACH UTILITY COMPANY'S AUTHORIZED ROE?

A. Yes. Just as the Company must compete for capital among fixed income investors in the debt capital markets, it must also be well positioned against its peers to attract equity capital. A pivotal factor in any investment decision is the risk-return profile of the subject company. Authorized ROE is of paramount importance because it sets a cap on the regulated company's ability to earn a return on invested capital and share that return with equity investors. If the Commission were to adopt the ORS's recommended 9.30% it could negatively impact DE Carolinas' ability to attract debt and equity capital on reasonable terms, especially in times of financial stress or under volatile market conditions.

Q. HAVE YOU CONSIDERED AUTHORIZED ROES OF OTHER COMPARABLE INVESTOR OWNED UTILITIES?

A. Yes. In the table below, I compare the current authorized ROEs of vertically integrated utilities located in the Southeastern United States.

Regulated Utility	State	Docket/Case No.	Year of Order	Current Authorized ROE
Georgia Power	GA	36989	2013	10.95%(1)
Entergy Mississippi	MS	2014-UN-0132	2014	10.07%
Florida Public Utilities Co.	FL	140025-EI	2014	10.25%
Florida Power & Light	FL	160021-EI	2016	10.55%
Kingsport Power Company	TN	16-00001	2016	9.85%
Virginia Electric and Power	NC	E-22, Sub 532	2016	9.90%
Duke Energy Florida	FL	20170183-EI	2017	10.50%(2)
Gulf Power	FL	160186-EI	2017	10.25%
Tampa Electric Co.	FL	20170210-EI	2017	10.25%
Duke Energy Carolinas	NC	E-7, Sub 1146	2018	9.90%
Duke Energy Progress	NC	E-2, Sub 1142	2018	9.90%
South Carolina Electric & Gas	SC	2017-370-E	2018	9.90%(3)
Average				10.19%

(1) Authorized retail ROE set under the 2013 Alternative Rate Plan approved by the Georgia Public Service Commission and evaluated against a range of 10.00% to 12.00%

(2) Represents the mid-point of an authorized range from 9.50% to 11.50%. ROE was originally authorized in the 2010 rate case (Docket No. 090079-EI) and re-authorized in a 2013 settlement and again in the 2017 settlement

(3) ROE is to be applied to the capital costs associated with the unrecovered balance of the VC Summer project regulatory asset. The commission actually determined the Cost of Equity to be 10.75%, but accepted SCE&G's proposal of 9.90% as part of the merger resolution.

Q. WHAT DID YOUR REVIEW DETERMINE?

A. When reviewing the authorized ROEs of comparable utility companies, it is clear the Company's requested 10.50% ROE is in-line with its regulated peers' current authorized ROEs. Witness Parcell's proposed ROE of 9.30% is 55 basis points below the lowest authorized ROE shown in the table above and would severely hinder DE Carolinas' ability to maintain its assets, make significant capital-intensive investments to the benefit of customers, and provide an adequate return to investors.

Q. MR. PARCELL'S RECOMMENDED ROE IS ONE PART OF THE REVENUE REQUIREMENT RECOMMENDED BY THE ORS. DO YOU HAVE ANY CONCERNS WITH THE OVERALL ORS RECOMMENDATION?

A. Mr. Parcell's recommended ROE does not exist in isolation, but rather is part of an overall recommendation by the ORS, summarized in Audit Exhibit GS-2. To fully understand the adverse impact to the Company's credit quality, the entire recommendation must be considered. Audit Exhibit GS-2 outlines a reduction of the current allowed ROE by 90 basis points, disallowance of incurred costs, and extending the period of recovery for other costs. Adopting the ORS position would exacerbate the magnitude of regulatory lag cited by the rating agencies and weaken DE Carolinas' credit metrics. On a quantitative basis, leverage would increase and cash flows to fund operations and service debt would decrease. In particular, the ORS's recovery approach for coal ash remediation costs would place downward pressure on credit metrics. In recent credit reports, both Moody's and S&P view the current DE Carolinas regulatory framework as a generally constructive, supporting long-term credit quality. Adopting the ORS position with a significantly lower ROE and reduced recovery for coal ash remediation could weaken this view. When considering a potential change to a company's credit ratings, it is important to consider the interplay of all components of credit quality. Moving one component changes how agencies view, or tolerate, other components. If the agencies' qualitative assessment is altered, they may require more robust financial metrics to offset the change. A final concern is how lower cash flows can adversely impact utility operations. If the ORS's recommendations are adopted, DE Carolinas would face weakening credit metrics, which would compromise its ability to undertake investments designed to improve the customer experience.

Q. GIVEN YOUR CONCERNS WITH HOW THE OVERALL ORS RECOMMENDATION WILL ADVERSELY IMPACT CREDIT QUALITY, HOW DO YOU BELIEVE FIXED INCOME INVESTORS WILL REACT IF THE RECOMMENDATION WERE TO BE ADOPTED?

A. When evaluating investment alternatives, fixed income investors use a set of criteria similar to that of the rating agencies. As previously stated, if the ORS recommendation were to be adopted, DE Carolinas' leverage would increase and cash flows would decrease. For a fixed income investor, the risk of investing in DE Carolinas' debt securities would increase. In order to compensate for the increased risk, investors would require a higher rate of debt. This would increase the cost of future debt issuances.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.